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SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69987; File No. SR-CBOE-2013-026)

July 15, 2013

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of Amendment No. 2 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment Nos. 1 and 2, Relating to Complex Orders

I. Introduction

On March 28, 2013, Chicago Board Options Exchange, Incorporated (the "Exchange" or "CBOE") filed with the Securities and Exchange Commission (the "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to amend its rules governing the trading of complex orders on the Exchange to adopt a new order type called "leg orders." On April 11, 2013, the Exchange filed Amendment No. 1 to the proposal. The proposed rule change, as modified by Amendment No. 1, was published for comment in the Federal Register on April 17, 2013.[3] The Commission received no comment letters regarding the proposed rule change, as modified by Amendment No. 1. On June 26, 2013, the Exchange filed Amendment No. 2 to the proposal.[4] The Commission is publishing this notice to solicit comments on Amendment No. 2 from interested persons and is approving the proposed rule change, as modified by Amendment Nos. 1 and 2, on an accelerated basis.

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 69364 (April 11, 2013), 78 FR 22326.

4 See infra Section II.B for a description of Amendment No. 2.

II. Description

A. Leg Orders

CBOE proposes to adopt CBOE Rule 6.53C(c)(iv) relating to the generation and execution of leg orders. A leg order would be a limit order on the CBOE electronic book ("EBook") that represents one leg of a non-contingent complex order resting on the complex order book ("COB") if the ratio of that leg to the other legs of the complex order is equal to or can be reduced to one (e.g., 1:1, 1:2, or 1:3).[5] A leg order would be a firm order that may be included in the Exchange's displayed best bid or offer ("Exchange BBO") on the EBook.[6] According to CBOE, leg orders are designed to increase opportunities for complex orders resting on the COB to leg into the CBOE individual options market and execute.[7]

1. Generation of Leg Orders

CBOE proposes that leg orders may be automatically generated on behalf of complex orders so that they are represented in the individual leg markets.[8] CBOE proposes that a leg order would be automatically generated for a leg of a complex order resting on the top of the COB: (1) if the price of the complex order is inside the "derived net market," which is based on the derived net price of the best-priced orders or quotes (other than leg orders) in the EBook; and (2) at a price at which the net price execution of the complex order can be achieved if the other leg(s) of the complex order executes against the best-priced orders or quotes (other than leg

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5 See proposed CBOE Rule 6.53(x). See also Notice, 78 FR at 22928, n. 4 for an explanation of conforming ratios as applied to the generation of leg orders.

6 See proposed CBOE Rule 6.53(x).

7 See Notice, 78 FR at 22928.

8 See proposed CBOE Rule 6.53C(c)(iv)(1).

orders).[9] To determine whether leg orders may be generated or displayed in accordance with proposed CBOE Rule 6.53C(c)(iv)(1)(A)-(C), CBOE would evaluate the COB when a complex order enters the COB, when the Exchange BBO changes, and at a regular time interval to be determined by the Exchange (which would not exceed one second).[10]

CBOE states that the derived net market and the price of leg orders would be based on the best-priced non-leg orders in the other leg series, as those are the orders against which a complex order may execute.[11] CBOE proposes that the size of a leg order would be the lesser of (1) the size of the complex order, and (2) the maximum size available in the EBook for the other leg(s) of the complex order (divided by the leg ratio, if applicable).[12]

CBOE proposes that it may, on an objective basis, limit the number of leg orders generated.[13] According to CBOE, leg orders may be made available on a class-by-class basis and may not be available for all of its systems.[14] CBOE believes that this would help the Exchange manage the number of leg orders generated to ensure that leg orders do not negatively impact the Exchange's system capacity and performance.[15] CBOE represents that it would not limit the generation of leg orders on the basis of the entering participant or the participant category of the order (i.e., professional, professional customer, or public customer).[16]

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9 See proposed CBOE Rule 6.53C(c) (iv)(1)(A); Notice, 78 FR at 22928, Example A, for an illustration of how leg orders would be generated and priced.

10 See proposed CBOE Rule 6.53C(c)(iv)(1).

11 See Notice, 78 FR at 22928, n. 6.

12 See proposed CBOE Rule 6.53C(c)(iv)(1)(C); Notice, 78 FR at 22930, Example D for an illustration of the maximum size limit as applied to the generation of leg orders.

13 See proposed CBOE Rule 6.53C(c)(iv)(1).

14 See id.

15 See Notice, 78 FR at 22928, n. 5. See also infra Section II.C.

16 See Notice, 78 FR at 22930, n. 15.

Finally, CBOE proposes not to generate a leg order if the price of the leg order would lock or cross the national best bid or offer ("NBBO").[17] CBOE also proposes to not generate leg orders for stock-option orders.[18]

2. Display and Nondisplay of Leg Orders; Aggregation of Size

CBOE's proposed rule change specifies when a leg order would be displayed and when it would be nondisplayed. A leg order would only be displayed on the EBook if the price of the leg order matches or improves the Exchange BBO pursuant to proposed CBOE Rule 6.53C(c)(iv)(1)(B).[19] A leg order would not be displayed on the Ebook if the price of the leg order does not match or improve the Exchange BBO.[20] If multiple resting complex orders in different strategies generate leg orders for the same price on the same side of an options series and both leg orders are eligible for display (i.e., both leg orders match or improve the Exchange BBO), then the leg order with the largest size would be displayed and the other leg orders would not be displayed.[21] If such leg orders are for the same size, then the first leg order generated would be displayed and the other leg order(s) would not be displayed.[22] If multiple resting complex orders in the same strategy generate leg orders for the same price on the same side of an options series, then the sizes of the leg orders would be aggregated and treated as a single order

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17 See proposed CBOE Rule 6.53C(c)(iv)(1)(A).

18 See proposed CBOE Rule 6.53C, Interpretation and Policy .06.

19 See proposed CBOE Rule 6.53C(c)(iv)(1)(B).

20 See proposed CBOE Rule 6.53C, Interpretation and Policies .12 and proposed CBOE Rule 6.53C(c)(iv)(1)(B).

21 See proposed CBOE Rule 6.53C(c)(iv)(1)(B); Notice, 78 FR at 22929-22930, n. 10-11, and Example C for an illustration of this concept.

22 See proposed CBOE Rule 6.53C(c)(iv)(1)(B).

until execution.[23] If such an aggregated order matched or improved the Exchange BBO, the aggregated order would be displayed.[24]

CBOE represents that nondisplayed leg orders, including leg orders that were displayed but subsequently become nondisplayed, would remain in the EBook and would be eligible for execution under proposed CBOE Rule 6.53C(c)(iv)(2), but would not be visible in the EBook depth, which, according to CBOE, contains resting orders and quotes not at the BBO.[25]

3. Priority and Execution of Leg Orders; Cancelation and Removal

CBOE represents that the generation of a leg order would not affect the existing priority, or execution opportunities, currently provided to market participants in the regular market in any way.[26] In this regard, CBOE proposes that leg orders (including nondisplayed leg orders) would execute only after all other executable orders and quotes (including any nondisplayed size) at the same price are executed in full and that a leg order may not execute against another leg order.[27] Leg orders at the same price would execute pursuant to the priority and execution rules for complex orders on the COB, except that displayed leg orders would have execution priority over nondisplayed leg orders.[28]

CBOE proposes that when a leg order executes against an incoming order or quote, the other leg(s) of the complex order represented by the leg order would automatically execute against the best-priced resting orders or quotes (other than leg orders) so that the complex order

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23 See proposed CBOE Rule 6.53C(c)(iv)(1)(C).

24 See Notice, 78 FR at 22930, n. 14.

25 See proposed CBOE Rule 6.53C, Interpretation and Policies .12; Notice, 78 FR at 22929, Example B, for an illustration of the generation of nondisplayed leg orders.

26 See Notice, 78 FR at 22930.

27 See proposed CBOE Rule 6.53C(c)(iv)(2)(A); Notice, 78 FR at 22928, n. 6.

28 See proposed CBOE Rule 6.53C(c)(iv)(2)(A).

would be executed in full or in a permissible ratio).[29] Prior to the execution of the complex order, any leg orders on the opposite side of the legs of the executing complex order would be canceled.[30] Upon execution of the complex order, any leg orders that represent other legs of the executing complex order would be canceled.[31] According to CBOE, after the complex order executes, new leg orders may be generated to "replace" any leg orders representing other complex orders resting on the COB that were cancelled as a result of the execution of the complex order, assuming such resting complex orders meet the requirements for the generation of leg orders under CBOE Rule 6.53C(c)(iv)(1).[32] In such an instance, CBOE states that the newly generated leg order(s) would have the same priority as the leg order(s) it replaced with respect to any other leg orders at the same price representing complex orders in the same strategy because the priority of the new leg order(s) (which would be aggregated) would be based on the priority of the complex orders they represent (which would remain unchanged regardless of cancellations of leg orders).[33] If execution of the complex order is partial, CBOE would be able to generate and display leg orders for the remaining size of the complex order assuming the conditions of Rule 6.53C(c)(iv)(1) are satisfied.[34]

CBOE proposes that a leg order would also be canceled if: (1) execution at the price of the leg order would no longer achieve the net price of the complex order when the other leg(s) executes against the best-priced orders or quotes (other than leg orders); (2) the complex order

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29 See proposed CBOE Rule 6.53C(c)(iv)(2)(B).

30 See id.

31 See proposed CBOE Rule 6.53C(c)(iv)(2).

32 See Notice, 78 FR at 22930, n. 17.

33 See id.

34 See proposed CBOE Rule 6.53C(c)(iv)(2)(B); Notice 78 FR at 22931, Example F, for an illustration of a partial execution of a complex order through its leg orders.

executes in full or in part against another complex order; or (3) the complex order from which the leg order was generated is cancelled or modified.[35] CBOE proposes that a leg order would be removed from display in the EBook if the price of the leg order is no longer at the Exchange BBO or if a complex order in a different strategy generates a larger-sized leg order at the same price.[36] Any leg order that is removed from display in the EBook would be nondisplayed, but would still be eligible for execution.[37]

4. Leg Orders and CBOE Auctions

CBOE proposes to amend certain provisions of CBOE Rule 6.53C, Interpretation and Policies, to provide for how leg orders would interact with the various auction functions available on the Exchange. First, CBOE proposes to amend CBOE Rule 6.53C, Interpretation and Policy .04(b) to provide that if a leg order has been generated for a complex order resting in the COB, the complex order would not be eligible for the automated complex order request for responses ("RFR") auction process ("COA").[38] CBOE believes that this provision is appropriate because leg orders would more effectively create opportunities for the execution of complex orders resting in the COB than having those complex orders participate in a COA after the complex order has reached the COB.[39]

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35 CBOE may also cancel a leg order that might trade ahead of a non-leg order against an all-or-none order. See proposed CBOE Rule 6.53C(c)(iv)(2)(C).

36 See proposed CBOE Rule 6.53C(c)(iv)(3)(A); Notice 78 FR at 22932, Example H for an illustration of cancellation and removal of leg orders generated from complex orders in different strategies.

37 See proposed CBOE Rule 6.53C(c)(iv)(3)(A); Notice 78 FR at 22931-22932, Examples G and H, for illustrations of how leg orders are canceled and removed.

38 See proposed CBOE Rule 6.53C, Interpretation and Policy .04.

39 See Notice, 78 FR at 22932.

Second, CBOE proposes to add CBOE Rule 6.53C, Interpretation and Policy .07 to determine whether CBOE would generate a leg order if a simple order auction[40] is occurring in a leg series at the time that a leg order in that series would otherwise be generated pursuant to CBOE Rule 6.53C(c)(iv). CBOE proposes that:

- If the leg order would be on the same side of the market as the auctioned order with a price worse than the initial auction price of the auctioned order, then the leg order would be generated and the auction would continue.[41]
- If the leg order would be on the same side of the market as the auctioned order with a price equal to or better than the initial auction price of the auctioned order, then no leg order would be generated and the auction would continue. A leg order may later be generated after execution of the auctioned order.[42]
- If the leg order would be on the opposite side of the market as the auctioned order with a price that locks or crosses the initial auction price of the auctioned order, then no leg order would be generated and the auction would continue. A leg order may later be generated after execution of the auctioned order.[43]
- If the leg order would be on the opposite side of the market as the auctioned order with a price that does not lock or cross the initial auction price of the auctioned order, then the leg order would be generated and the auction would continue.[44]

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40 CBOE's simple order auctions include the Hybrid Agency Liaison ("HAL") auction described in CBOE Rule 6.14A and Automated Improvement Mechanism ("AIM") auction described in CBOE Rule 6.74A.

41 See proposed CBOE Rule 6.53C, Interpretation and Policy .07(a).

42 See proposed CBOE Rule 6.53C, Interpretation and Policy .07(b).

43 See proposed CBOE Rule 6.53C, Interpretation and Policy .07(c).

44 See proposed CBOE Rule 6.53C, Interpretation and Policy .07(d).

CBOE notes that a leg order would not participate in an auction if a leg order would (a) be displayed in an options series at the time an auction order enters the system and (b) be at the same price as the starting price of the auction order and on the opposite side of the auction order.[45] According to CBOE, the auction order would instead trade with other resting interest at that price and/or any contra order that stopped the auctioned order, while the leg order could continue to be displayed during the auction.[46] According to the Exchange, this result occurs because leg orders only trade after all other executable orders and quotes are executed first.[47]

CBOE believes the proposal would ensure that leg orders would not interact with simple order auctions in order to avoid the system complexities that would result from combining the execution of complex orders with the already complex auction processes.[48] The Exchange believes that market participants would continue to have the same opportunities for execution and potential price improvement through simple order auctions as they would if there were no leg orders present.[49]

B. Amendment No. 2 to the Proposed Rule Change

In Amendment No. 2, the Exchange proposes to make two changes to proposed CBOE Rule 6.53C(c)(iv). First, Amendment No. 2 adds a provision to proposed CBOE Rule 6.53C(c)(iv) to provide that leg orders will only be generated in the minimum increment of the leg series, and the price of a leg order will be rounded down (bid) or up (offer) to the nearest

45 See Notice, 78 FR at 22933.

46 See id.

47 See id.

48 See Notice, 78 FR at 22932.

49 See Notice, 78 FR at 22933.

minimum increment if it would otherwise be priced in a smaller increment than the minimum.[50] CBOE represents in Amendment No. 2 that leg orders rounded pursuant to this provision will be ranked, displayed, and eligible to execute with incoming orders at the rounded price. According to Amendment No. 2, a leg order rounded to the nearest increment will function in the same manner as a non-rounded leg order at the rounded increment. Second, Amendment No. 2 eliminates proposed CBOE Rule 6.53C(c)(iv)(2)(C), which governed the interaction of leg orders with all-or-none orders. The Exchange originally proposed that an all-or-none order[51] would only execute against a leg order if it was at least the same size as the all-or-none order and there were no non-leg orders at the Exchange BBO.[52] Under proposed CBOE Rule 6.53C(c)(iv)(2)(C), as originally proposed, if a leg order and a non-leg order(s) were at the Exchange BBO, then the all-or-none order would have either (a) executed against the non-leg order(s) if it was at least the same size as the all-or-none order or (b) the leg order would have been cancelled and the all-or-none order would have been handled pursuant to CBOE's existing rules governing all-or-none orders.[53] Pursuant to CBOE Rule 6.53C(c)(iv)(2)(C), no new leg orders in the applicable options series would have been generated until the all-or-none order was executed or cancelled.[54] As amended, proposed CBOE Rule 6.53(c)(iv)(2)(C) will be eliminated in its entirety and, as a result, a marketable all-or-none order could execute against a leg-order and a non-leg order displayed at the Exchange BBO if such orders were together sufficient to fill the marketable all-or-none order.

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50 See proposed CBOE Rule 6.53C(iv)(1)(A).

51 See CBOE Rule 6.53(i) defining an all-or-none order as: "a market or limit order which is to be executed in its entirety or not at all."

52 See proposed CBOE Rule 6.53C(c)(iv)(2)(C).

53 See id. See generally CBOE Rule 6.44 Interpretations and Policies .01 - .03.

54 See proposed CBOE Rule 6.53C(c)(iv)(2)(C).

C. CBOE Trading System Capacity

CBOE represents that it maintains a rigorous capacity planning program that monitors system performance and projected capacity demands and that, as a general matter, considers the potential system capacity impact of all new initiatives.[55] CBOE represents that it has analyzed the potential impact on system capacity that may result from the proposed rule change and has concluded that the Exchange has sufficient system capacity to handle the generation of leg orders without degrading the performance of its systems or reducing the number of complex order instruments it currently supports.[56] The Exchange represented that it would closely monitor the generation of leg orders and its effect on CBOE's systems, and would carefully manage and curtail the number of leg orders being generated, to ensure that they do not negatively impact system capacity and performance.[57]

III. Discussion

After careful review, the Commission finds that the proposed rule change, as modified by Amendment Nos. 1 and 2, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.[58] In particular, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act,[59] which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and

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55 See Notice, 78 FR at 22933.

56 See id.

57 See id.

58 In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

59 15 U.S.C. 78f(b)(5).

open market and a national market system, and, in general, to protect investors and the public interest.

The Commission believes that leg orders could facilitate the execution of complex orders resting on CBOE's COB by increasing the opportunities for eligible complex orders to execute against interest in the leg market on CBOE's EBook, thereby benefitting investors seeking to execute complex orders. In addition, the Commission believes that leg orders could benefit participants in the leg market by providing additional liquidity, and potentially more favorable executions, for leg market interest. The Commission notes that it previously approved proposals by other options exchanges to implement leg orders.[60]

Leg orders will be firm orders that represent one leg of a non-contingent complex order resting on the COB if the ratio of that leg to the other legs of the complex order is equal to or can be reduced to one.[61] The Commission notes that, on CBOE, leg orders will only be generated in the minimum increment of the leg series, and the price of the leg order will be rounded down (bid) or up (offer) to the nearest minimum increment if it would otherwise be priced in a smaller increment than the minimum.[62] As noted above, the Exchange represents that a leg order rounded to the nearest increment will be ranked, displayed, and eligible to execute with incoming orders at the rounded price and that rounded leg orders will function in the same manner as non-

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60 See Securities Exchange Act Release Nos. 66234 (January 25, 2012), 77 FR 4852 (January 31, 2012) (order approving File No. SR-ISE-2011-82) and 69419 (April 19, 2013), 78 FR 24449 (April 25, 2013) (order approving File No. SR-BOX-2013-01).

61 See supra Section II.A.

62 See proposed CBOE Rule 6.53C(iv)(1)(A). See also supra Section II.B.

rounded leg orders.[63] Under CBOE's proposal, leg orders will not be generated if the price of the leg order would lock or cross the NBBO.[64]

The Commission notes that a leg order will be executed only after all other executable orders and quotes (including any nondisplayed size of any non-leg orders) at the same price are executed in full and that a leg order may not execute against another leg order.[65] Accordingly, CBOE represents that the generation of a leg order would not affect the existing priority, or execution opportunities, currently provided to market participants in the regular market in any way.[66]

The Commission notes that the proposal provides for when a leg order will be displayed and when it would be nondisplayed. The Exchange represents that nondisplayed leg orders will function in the same manner as displayed leg orders except that displayed leg orders will have priority over nondisplayed leg orders.[67]

As noted above, CBOE represents that it will carefully manage and curtail the number of leg orders being generated so that they do not negatively impact system capacity and performance.[68] CBOE represents, further, that it will curtail the number of leg orders on an objective basis, such as by limiting the number of leg orders generated in a particular class, and

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63 See supra Section II.B.

64 See proposed CBOE Rule 6.53C(c)(iv)(1)(A). See also supra note 17 and accompanying text.

65 See proposed CBOE Rule 6.53C(c)(iv)(2)(A); Notice, 78 FR at 22928, n. 6. See also supra notes 27 and 46 and accompanying text.

66 See Notice, 78 FR at 22930. See also infra note 26 and accompanying text.

67 See Notice, 78 FR at 22929.

68 See supra Section II.C.

that it will not limit the generation of leg orders on the basis of the entering participant or the participant category of the order (i.e., professional, professional customer, or public customer).[69]

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No. 2 is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-CBOE-2013-026 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-CBOE-2013-026. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F

69 See Notice, 78 FR at 22930, n. 15.

Street, NE, Washington, D.C. 20549-1090 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal offices of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-CBOE-2013-026, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 2

The Commission finds good cause for approving the proposed rule change, as amended by Amendment No. 2, prior to the 30th day after the date of publication of notice in the Federal Register. Amendment No. 2 revises the proposal, to, among other things, eliminate proposed CBOE Rule 6.53C(c)(iv)(2)(C) in its entirety because the provision would be inconsistent with Section 11A of the Act[70] and Rule 602(a) of Regulation NMS ("Quote Rule").[71] For this reason, the Commission finds good cause for approving the proposed rule change, as amended, on an accelerated basis, pursuant to Section 19(b)(2) of the Act.

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70 15 U.S.C. 78k-1.

71 17 CFR 242.602(a). See 17 CFR 242.602(a)(1)(i).

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[72] that the proposed rule change (SR-CBOE-2013-26), as amended, be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[73]

Kevin M. O'Neill
Deputy Secretary

[FR Doc. 2013-17312 Filed 07/18/2013 at 8:45 am; Publication Date: 07/19/2013]

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72 15 U.S.C. 78s(b)(2).

73 17 CFR 200.30-3(a)(12).